

## Business Review

- The acquisition of assets and businesses in the four northern provinces significantly strengthened the Company's leading position in the relevant market.
- Broadband services have become the chief driver of revenue growth for the Company, contributing 55.8% to the increase in revenue (excluding upfront connection fee). The number of broadband subscribers increased by 35.1% over last year.
- Fixed-line telephone services maintained a healthy rate of growth with the number of subscribers increasing by 6.7%. The number of PHS subscribers increased by 23.6%. The Company achieved 92.3% market share in its northern service region.
- Value-added services continued to see rapid growth. Value-added revenues increased by 33.6% over last year, and became one of the main drivers of overall revenue growth.
- The Company's competitive advantages in the business segment were further consolidated. Bandwidth subscribed by corporate customers grew by 78.1% from last year.
- Capital expenditures continued to decline and as a percentage of total revenues dropped by 2.8 percentage points compared with last year.
- For the fourth year in a row, the Company ranked first in a telecommunications industry customer satisfaction survey conducted by the Ministry of Information Industry.

"Growth and efficiency" were the goals of corporate and strategic development in 2005. We executed a two-pronged strategy. In the fixed-line business, we were able to attract and retain customers and strengthen our dominance in the northern service region by offering first class services, and ensuring the stable growth of fixed-line business. In our high-growth broadband and value-added services, we were able to leverage our enormous subscriber base to achieve sustainable growth and transform towards the strategic goal of becoming a "broadband communications and multi-media services provider".

In 2005, the Company recorded strong growth across business sectors. The Company achieved revenues in 2005 of RMB83.83 billion (excluding upfront connection fees), representing an increase of 5.9% from the previous year. Broadband and value-added services remained the major drivers for revenue growth. The number of fixed-line telephone subscribers grew by 6.7% over 2004 to 115.328 million. The Company achieved a 92.3% market share in the northern service region and consolidated its dominance in such market. The number of broadband subscribers grew by 35.1% to 11.475 million, and achieved 87.6% market share in the northern service region. Value-added services continued to expand rapidly, with a contribution to total revenue of 4.8%. This represented an increase of 33.6% over last year. In the business customers market, a number of factors strengthened the Company's competitiveness, including the launch of "CNC Connected", the Company's geographical advantage in the capital city, and its ability to provide one-stop global communications networking services. As a result, bandwidth subscribed by corporate customers grew by 78.1% over the previous year.

## Business Review

### Summary of Key Products

#### Fixed-line Telephone Services

■ 115.328 million subscribers (including PHS)

■ 92.3% market share<sup>(1)(2)</sup>

■ 81.8% of revenue<sup>(3)(4)</sup>

■ 2.9% growth<sup>(4)</sup>

#### Broadband and Other Internet-related Services

■ 11.475 million broadband subscribers

■ 87.6%<sup>(1)(2)</sup> broadband market share

■ 10.0% of revenue<sup>(4)</sup>

■ 34.6% growth

#### Business and Data Communications Services

■ Premium customer base

■ Leading provider in the northern service region

■ 4.3% of revenue<sup>(4)</sup>

■ 0.5% growth<sup>(4)</sup>

#### International Telecommunications Services

■ 1,854 international corporate customers

■ Leading operator in the Asia-Pacific region

■ 3.9% of revenue<sup>(4)</sup>

■ 23.2% growth<sup>(4)</sup>

<sup>(1)</sup> As of December 31, 2005

<sup>(2)</sup> In our northern service region

<sup>(3)</sup> Including other services revenues

<sup>(4)</sup> Excluding upfront connection fees

34

The following table illustrates the key operating data in 2005 and 2004:

	2004	2005	% / increase / decrease
Fixed-line subscribers ('000)	108,079	<b>115,328</b>	6.7%
Including: PHS subscribers ('000)	22,124	<b>27,337</b>	23.6%
Broadband subscribers ('000)	8,492	<b>11,475</b>	35.1%
Total usage (pulses in millions)	234,661	<b>228,436</b>	-2.7%
Excluding Internet dial-up usage (pulses in millions)	217,435	<b>219,884</b>	1.1%
Internet dial-up usage (pulses in millions)	17,226	<b>8,552</b>	-50.4%
Domestic long distance calls (minutes in millions)	29,366	<b>30,975</b>	5.5%
International long distance calls (minutes in millions) <sup>(1)</sup>	471	<b>591</b>	25.5%
Number of ports for DDN (ports)	150,630	<b>131,812</b>	-12.5%
Number of ports for Frame Relay (ports)	43,078	<b>43,519</b>	1%
Number of ports for ATM (ports)	4,816	<b>4,212</b>	-12.5%
Digital circuits leased (x2Mbps)	91,103	<b>129,989</b>	42.7%
Volume of PHS short messages (in millions)	1,988	<b>6,777</b>	240.9%
"Personalised Ring" service subscribers ('000)	630	<b>6,814</b>	981%
Penetration rate for caller identification (%)	60.4%	<b>65.9%</b>	5.5ppt
Telephone information services (million minutes)	2,969	<b>3,084</b>	3.9%

<sup>(1)</sup> International long distance call volume includes calls to Hong Kong, Macau and Taiwan.

### Broadband and other Internet-related Services

The broadband and internet service markets of the PRC recorded rapid growth as a result of sustained rapid economic growth and the swift penetration of the Internet in the PRC, as well as the aggressive push to digital technologies by the PRC government for the purposes of enhancing national and industrial competitiveness. In 2005, the broadband segment continued to grow in scale. The number of broadband subscribers increased by approximately 2.983 million a growth rate of 35.1%, making the segment the Company's most important growth driver. As a result of vigorous market competition, the Company's market share in the northern service region dropped to 87.6% in 2005, although the Company still maintained its leading position in the market.

In order to enhance the market penetration rate of its broadband services, the Company is offering a diverse range of products with different price packages to satisfy the individual needs of customers. Catering to business customers' diversified needs, the Company launched DSL private lines and optical fibre access products at a range of different speeds, with integrated broadband access products bundled with applications such as corporate web hosting, email, office automation and a sales management platform. In view of the increased demand for Internet services from students during the summer vacation, the Company launched new broadband access products such as "Holiday Broadband" and "Green Internet". These have been bundled with broadband content and application services and jointly promoted with computer manufacturers, which has effectively stimulated the demand for broadband services among household subscribers. Targeting the huge cyber café market, the Company cooperated with cyber cafés under the brand name of "CNC Garden" through franchise licensing. In December 2005, China Netcom Group was officially granted an "Internet Cultural Operating Permit" by the Ministry of Culture which is applicable nationwide. As such, the Company will expand its chain of cyber cafés, building on its advantage of a strong brand image and solid Internet resources.

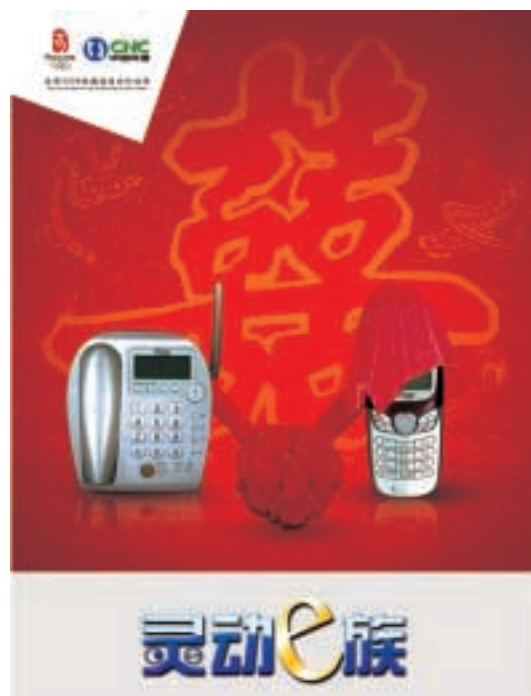
Development of the Company's broadband subscriber base:

Unit: '000 subscribers	2003	2004	2005
Number of broadband subscribers	3,346.2	8,492.4	<b>11,475.2</b>
Including: DSL	2,708.9	5,956.2	<b>8,568.4</b>
LAN	636.6	2,533.2	<b>2,904.2</b>
Northern service region	3,313.4	8,146.4	<b>11,036.2</b>
Including: DSL	2,708.9	5,939.2	<b>8,529.2</b>
LAN	603.8	2,207.2	<b>2,507.0</b>
Southern service region	32.8	346	<b>439</b>

## Business Review

Although access speed and price are still the decisive factors in the broadband market at present, the Company believes that development in broadband content and applications is the key to sustainable growth. The Company has achieved innovations and breakthroughs in content and applications through both proprietary development and collaboration with third parties. The Company has entered into cooperation with approximately 500 content and applications providers in the businesses of live webcasting, virtual theater, video conferencing, IPTV, online education, and broadband games. Besides basic services such as games, video and portals, the Company has also launched a series of dedicated services catering to the specific needs of local markets and industry subscribers, namely integrated tax payment services platform, digital libraries and digital photo-finishing. In 2005, the Company's exploration and promotion of commercial applications of IPTV also paid off well. The Company successfully launched China's first IPTV services in Harbin, Heilongjiang Province.

As a result of economies of scale arising from its huge subscriber base and due to rapid growth, in 2005 the Company's investment per line and procurement costs of equipment for the DSL platform continued to decline. The Company's broadband business maintained a satisfactory return on investment.



36

### Fixed-line Telephone Services

The Company's core business in fixed-line telephones was able to secure its existing customer base and continue to dominate the market for new customers in 2005. The number of fixed-line telephone subscribers increased by 6.7% from the same period last year to 115,328 thousand, with 7,249 thousand new subscribers. The Company achieved 92.3% market share in the northern service region.

Unit: '000 subscribers	2003	2004	2005
Total number of fixed-line subscribers	94,073	108,079	<b>115,328</b>
Northern service region	93,840	107,571	<b>114,658</b>
Including: residential	68,957	70,638	<b>70,273</b>
business	8,671	9,251	<b>10,725</b>
PHS	11,796	22,124	<b>27,329</b>
public telephones	4,416	5,558	<b>6,331</b>
Southern service region	233	508	<b>670</b>

### Local Telephone Services

In 2005, in local telephone services, the Company focused on the issues of loss of existing customers and consolidating its lead in new customers. The Company continued to optimize its PHS network in 2005, which improved the voice quality and further reinforced advantages of PHS services in terms of lower service fees and less radiation than that generated by mobile networks. The number of new subscribers to PHS services amounted to 5.21 million, accounting for 71.9% of the total number of new local telephone service subscribers. This reflected a successful mitigation of risks associated with mobile substitution and market competition. Meanwhile, The Company established a customer loss alert and retention programme. Together with the Company's community manager system, it has helped to reinforce customer retention, enabling us to effectively prevent the loss of customers and business to other fixed-line competitors. The Company leveraged its competitive edge as a multiple telecommunications services provider and bundled products for fixed-line, broadband and PHS telephone services in order to increase service value to subscribers. This value-added measure for subscribers has strengthened loyalty to the Company. Consequently, the Company managed to control customer losses and recruit new customers. The Company has aggressively explored the markets of urban commercial buildings and new residential districts, as well as wealthy rural areas. As a result, the Company successfully expanded its subscriber base for local telephone services, and more importantly, has reinforced its strategic development platform for the development of broadband business.

In addition to retaining existing subscribers and attracting new ones, the Company stabilized subscriber MOU by encouraging the use of fixed-line telephones. The strategy produced a slowdown in the decline of fixed-line telephone usage in the second half of 2005. Tapping into the key customer groups and market segments, the Company adopted various measures including the launch of differentiated monthly packages to promote the return of old users and stimulate nil volume users, which effectively promoted growth in phone traffic. Reflecting customer preferences, the Company has developed new fixed-line terminals and successfully launched a new phone terminal named "One Touch", which bundled 114, weather forecast and call forwarding services, etc. The package quickly acquired a subscriber base of over 1.6 million subscribers. In December 2005, the Company launched "Home Box", which integrates PHS and fixed-line telephone services. A pilot project as the Company moves towards Fixed-Mobile Convergence (FMC), "Home Box" will help to reinvigorate use of fixed-line services and will have a very positive impact on the Company's future mobile business.

In 2005, the Company's local telephone usage excluding Internet dial-up usage reached 219.88 billion pulses, an increase of 1.1% over the same period last year. Because of the gradual migration of narrow-band subscribers to broadband services, local telephone Internet dial-up usage continued to decline to 8.55 billion pulses, representing a decline of 50.4% from last year.

## Business Review



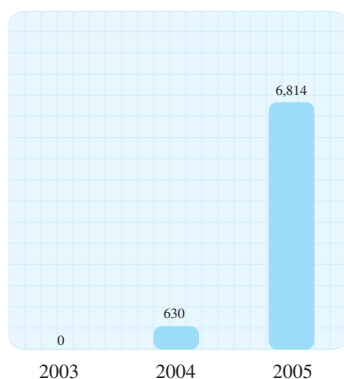
### Value-added Services

In order to fully leverage the Company's large subscriber base and stabilize the ARPU of its fixed-line phone services, the Company is committed to avoiding price competition by aggressively developing value-added services. In 2005, fixed-line telephone value-added services grew rapidly and achieved scale growth in all services including PHS short messages, "Personalised Ring" services, caller identification, and telephone information services. This business segment has become a major driver of revenue growth for the company's fixed-line telephone services and a key segment for enhancing the Company's operational competitiveness.

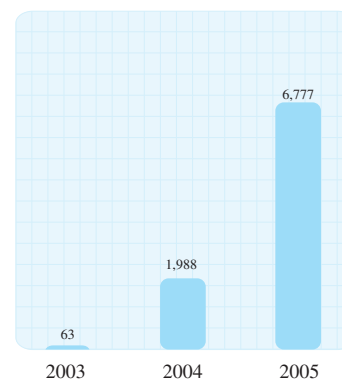
As of the end of 2005, the volume of PHS short messages was 6.78 billion, an increase of 240.9% over the previous year. The number of "Personalised Ring" service subscribers reached 6.81 million, representing a year-on-year increase of 981%. Caller identification penetration rate grew by 5.5 percentage points from the previous year to 65.9%.

The growth in value-added services to some extent compensated for the decline in ARPU of the traditional local fixed-line telephone business. Value-added services enjoyed a relatively higher return on investment due to lower investment costs.

**2003-2005 Growth in the number of our Personalized Ring Subscribers (in thousands)**



**2003-2005 Growth in volume of SMS (in millions)**



## Business Review

### Long Distance Services

Unit: million minutes	2003	2004	2005
Domestic long distance calls	26,330	29,366	<b>30,975</b>
Including: Traditional network	15,220	15,546	<b>15,979</b>
VOIP	11,110	13,820	<b>14,996</b>
Northern service region	24,294	27,047	<b>27,775</b>
Including: Traditional network	15,190	15,087	<b>15,653</b>
VOIP	9,104	11,960	<b>12,122</b>
Southern service region	2,036	2,319	<b>3,200</b>

Reflecting the increasing popularity of VOIP phone and fierce price competition, the Company's market share in the long distance service sector declined in 2005 despite marked growth in usage over last year. In 2005, domestic long distance usage increased by 5.5% over the same period last year, while the Company's market share in the northern service region fell by 3.4 percentage points from 2004 to 38.3%. International long distance call usage, including long distance calls made to Hong Kong, Macau and Taiwan, increased by 25.5% over the same period last year, while market share in the northern service region dropped by 5.6 percentage points from the same period last year to 48.7%.

Unit: million minutes	2003	2004	2005
International long distance calls	458	471	<b>591</b>
Including: Traditional network	187	158	<b>173</b>
VOIP	271	313	<b>418</b>
Northern service region	365	339	<b>352</b>
Including: Traditional network	186	148	<b>156</b>
VOIP	179	191	<b>196</b>
Southern service region	93	132	<b>239</b>

### Interconnection Services

With overall growth in the domestic telecommunications market and expansion of the Company's customer base, as a result inbound call volume and revenues from interconnection service between the Company and other operators increased. The volume of inbound calls through the Company's networks increased by 27.1% in 2005 compared to the same period in the previous year.

## Business Review

### Business and Data Communications Services

Unit: ports	2003	2004	2005
Number of ports			
DDN (ports)	153,838	150,630	<b>131,812</b>
Frame Relay (ports)	36,683	43,078	<b>43,519</b>
ATM (ports)	1,239	4,816	<b>4,212</b>
Leased line bandwidth			
DDN (x 64kbps)	319,812	319,323	<b>205,064</b>
Frame Relay (x 128kbps)	47,123	82,395	<b>177,016</b>
ATM (x 2Mbps)	10,010	23,262	<b>12,316</b>
MPLSVPN (x 2Mbps)	10	125	<b>311</b>
Leased circuit bandwidth (x 2Mbps)	84,138	91,103	<b>129,989</b>
Business customers (x 2Mbps)	39,942	56,363	<b>100,387</b>
Carrier customers (x 2Mbps)	44,196	34,740	<b>29,602</b>

40

The business service market has long been a focus of the Company's growth strategy. The Company is able to leverage its competitive advantage of its geographical location in the nation's capital, Beijing, its network resources, business innovation capability and ability to provide one-stop solutions to dominate the business service market. In 2005, the Company launched the "CNC Connected" brand targeting the business service market, providing one-stop communications solutions catering to needs of business customers in different sectors. The Company improved its marketing and service systems for major customers. Dedicated managers were appointed to serve these customers. Members of the Company's management team served as chief representatives in charge of key customers. During the year, the Company strengthened its dominance of the business service market. Due to robust growth in demand in the business segment, its total leased circuit bandwidth was 100387 x 2M, representing an increase of 78.1% over the previous year.

### International Telecommunications Services

The Company has always attached great importance to the development of international telecommunications services and aims to become the leading alliance partner for foreign telecommunication operators in the PRC, providing one-stop, end-to-end telecommunication and networking services to an increasing number of multinational companies in the PRC. The Company's strategy is to use its international business as a driving force for growth of its domestic service. Capitalizing on its extensive cooperation with foreign telecommunication operators and its proprietary international network resources, the Company offers end-to-end global telecommunication network services for an ever-increasing number of Chinese corporate customers that are seeking to "go global". These services helped to further fortify the Company's position in this segment.

As of the end of 2005, the international business of the Company spanned 263 countries and regions around the globe. International telecommunications services were provided to 1,854 international corporate customers, with an annual growth rate in subscriber base of 30.1%. In 2005, international incoming calls amounted to 2.09 billion minutes, representing an increase of 21.2% over the same period last year. Access bandwidth the Company provided for international managed data services amounted to 21,458 units, representing an increase of 94.3% over the previous year.



## Business Review

### Branding

To better support the Company's broadband strategy, in 2004 the Company launched a new core brand of "A Broadened World". In 2005, the Company launched "CNC MAX", a new brand for its broadband services targeted at residential and individual users. In order to support its strategy for business customers, the Company has restructured "CNC Connected," its brand for business customers. These two brands are providing a solid foundation for marketing and development of broadband businesses.



### Marketing and Customer Service

In 2005, the Company thoroughly revised marketing and sales channels in the northern service region, based on a new community manager system. It established a cross-marketing system on the basis of the Company's major account managers, community managers, sales outlets, 10060 telephone marketing, online marketing, and third partners.



Over 40,000 community managers carried out direct marketing through on-site cold-calling, which significantly enhanced the Company's product sales and service quality. To ensure the effectiveness of the community manager marketing strategy, the Company set key performance indicators for community managers on certain criteria such as sales revenue, sales growth, service and maintenance.

In 2005, the Company improved its system of chief representatives for key accounts and provided one-stop global services to major customers. Centralised or separate settlement options were offered based on the clients' needs. In response to growing demand of business customers for communications, networking and IT services, in 2005 the Company promoted a wide range of customized value-added applications and integrated solution packages through promotion activities such as road show targeting specific groups of customers.

In 2005, the Company was able to improve customer satisfaction and, for the fourth consecutive year, ranked the first in a customer satisfaction survey conducted by the Ministry of Information Industry.

## Business Review

### Network Construction

In 2005, the Company increased investment in growth business networks and pilot networks of new technologies. In order to ensure the growth of its rapidly expanding broadband business, the Company made substantial investments in broadband and supporting networks. In 2005, investments in broadband and data services accounted for 26.4% of the Company's total investments, at RMB7.3 billion, representing an increase of 9.8% over the same period last year. In 2005, the Company completed network-intelligentizing projects for 38 local networks, which helped the Company to adopt flexible marketing initiatives such as cross-service bundling, as well as to provide better customer services and respond quickly to changes in the market.

The Company's investment in the PHS network declined from RMB8.1 billion in last year to RMB5.6 billion in 2005. Investment in the PHS network was mainly for network optimization and provision of value-added services. In the traditional fixed-line network, investment was applied for market expansion on the one hand, and for network optimization on the other, which enhanced network utilization, improved service quality, and earned at the loyalty of our customers. In 2005, the Company's investment in its fixed-line telephone business, including value-added services, was RMB6.8 billion.

As part of its efforts to apply new technology and to complete its strategic transformation, the Company embarked on construction of a pilot soft-switch network and a pilot broadband IP carrier network. It also initiated pilot commercial projects for new technologies such as IPv6 and ASON, preparing for an anticipated large-scale evolution of its network in the future.

In 2005, the Company further its existing policies of standardizing administrative procedures for fixed assets investment and centralizing procurement policy, for the purpose of enhancing network utilization and investment returns while reducing investment risks.

### Support System Construction

In 2005, the Company formulated a "Tri-Integration" development strategy for its corporate information system. This will enable gradual integration and standardization of its three major systems – application systems, the data center and the transport network carrying the application systems. The strategy aims at enhancing management transparency and the Company's ability to support integrated businesses and respond to the market, and is a key part of preparations for strategic transformation of the Company.

In 2005, a "2+1" project was launched as part of the implementation of the "Tri-Integration" strategy. The project involved the full-scale deployment of ERP and the centralization of billing systems at the provincial level, and, based on the needs of these two systems, optimization and integration of the DCN network for data carrying and transmission. This project is expected to be completed in 2006. Upon completion, the Company's back office information system will see substantial improvements in terms of maintenance costs and management efficiency. The "2+1" project is expected to enhance market responsiveness and business support capability, by facilitating quick decision-making for the Company's management and operations, control of operating risks and improvement of internal controls.